

Internal Revenue Service  
**memorandum**

CC:TL:TS/JLRICKS  
TL-N-5512-89

date: JUN 29 1989

to: District Counsel, Houston SW:HOU

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [REDACTED]

This tax litigation advice is in response to your request for advice dated March 29, 1989.

Issue

Whether section 6661 is applicable to underpayments for taxable years for which the return is due prior to January 1, 1983, when the underpayment resulted from the disallowance of a net operating loss ("NOL") carryback created in a taxable year for which a return is due subsequent to December 31, 1982?

Conclusion

Section 6661 should not be applied to an underpayment in a year for which the return is due prior to January 1, 1983, even though it was caused by the disallowance of a NOL carryback from a year for which the return is due after December 31, 1982.

Facts

[REDACTED] filed a federal income tax return for [REDACTED] prior to December 31, 1982. In [REDACTED], [REDACTED] was a partner in [REDACTED], a non-Tefra partnership in the [REDACTED] tax shelter. As a result of his investment, a \$[REDACTED] NOL was created for tax year [REDACTED]. In [REDACTED], [REDACTED] filed a Form 1045, Application for Tentative Refund. On the Form 1045, he claimed a NOL for [REDACTED] and carried back the unused NOLs to the [REDACTED] tax year. On [REDACTED], the Service issued [REDACTED] a refund for [REDACTED] of approximately \$[REDACTED] as a result of the [REDACTED] NOL carryback.

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The Service disallowed the NOL. The Service issued a statutory notice of deficiency in which it determined deficiencies in years [REDACTED] and [REDACTED] in the amount of \$ [REDACTED] and \$ [REDACTED], respectively. In the statutory notice of deficiency, the Service also asserted an addition to tax under section 6661 of \$ [REDACTED] for year [REDACTED] and \$ [REDACTED] for year [REDACTED]. The Houston District Counsel recommends that section 6661 be conceded for year [REDACTED].

#### Discussion

Section 6661(a) provides that:

[i]f there is a substantial understatement of income tax for any taxable year, there shall be added to the tax an amount equal to 25 percent of the amount of any underpayment attributable to such understatement.

This section is effective for returns the due date for filing of which, regardless of extensions, is after December 31, 1982. Sec. 323, Tax Equity and Fiscal Responsibility Act, Pub. L. 97-248, 96 Stat. 324 (Sept. 3, 1982), 1982-2 C.B. 462. The House Conference Report for Public Law 97-248 reiterates this general language. It states that "the penalty would be effective with respect to returns which have a due date after 1982." H.R. Conf. Rep. No. 530, 97th Cong., 2d Sess. 574 (1982).

Although the language of the statute is unclear whether section 6661 can be applied to a substantial understatement in a pre-1982 year resulting from a carryback from a post 1981 year, the Treasury Regulations under section 6661 address this question. Treas. Reg. § 1.6661-1(b) provides that:

The penalty does not apply to amended returns, so-called, if the due date for the return to which the amended return relates (determined without regard to extensions) is before January 1, 1983.

This language makes clear that the penalty will not apply to an amended return filed after December 31, 1982 which claims a carryback for a tax year for which the return is due prior to January 1, 1983. Since an individual may obtain a refund of taxes resulting from an NOL carryback by filing either an Amended return or an Application for Tentative Allowance on Form 1045, we believe that the penalty would not be applied to a Form 1045 filed after December 31, 1982 that claims a carryback for a tax year for which a return is due prior to January 1, 1983. Accordingly, the section 6661 penalty will not apply to an underpayment in [REDACTED] which results from a NOL carryback which was generated from losses created in [REDACTED].

Because the explicit language in Treas. Reg. § 1.6661-1(b) is dispositive of this issue, we find the cases discussing the imposition of section 6659 to carryback years prior to the effective date of that section to be inapplicable to the instant case. In contrast to section 6661, the wording of the effective date provision for section 6659 does not provide a specific due date for those returns to which the section is applicable. Section 6659, which was enacted by the Economic Recovery Tax Act of 1981, is effective for "returns filed after December 31, 1981." Sec. 722(a)(4), Economic Recovery Tax Act of 1981, Pub. L. 97-34, 95 Stat. 341, 1981-2 C.B. 256. The language of the statute is broad enough to apply section 6659 to amended returns which relate to tax years prior to December 31, 1981. Moreover, there are no Treasury Regulations under section 6659 which have limited the broad wording of the effective date provision.

Thus, the Tax Court was not faced with a similar provision to Treas. Reg. § 1.6661-1(b) in Neilsen v. Commissioner, 87 T.C. 779 (1986). In Neilsen, the Tax Court held that section 6659 is applicable to underpayments of tax in years 1978 and 1979 when such underpayments resulted from the disallowance of investment tax credit carrybacks claimed in 1981 and 1982 (for which returns were filed after December 31, 1981). The Court reasoned that section 6659(c) provides that the penalty is applicable to underpayments attributable to the overstatement of the value or adjusted basis of property "on any return." 87 T.C. at 781. Thus, the addition to tax applies "regardless of whether the overvaluation or overstatement is made on the return for the year of the underpayment or whether it is made on a return for an earlier or later period." 87 T.C. at 781-782.

The legislative history of section 6659 discusses the application of the addition to tax in carryover and not carryback situations. However, the Court in Neilsen found that it was inconceivable that Congress did not intend to penalize taxpayers who made a valuation overstatement on a return after the effective date of the section and carried back the tax benefits of the overstatement to prior years, when the addition to tax was intended to deter these overstatements. 87 T.C. at 783. Moreover, the Court noted that it previously ruled that "an item carried back from a later year to an earlier year, is 'attributable to' the adjustment in the later year." Herman Bennett Co. v. Commissioner, 65 T.C. 506 (1975) (Court found that erroneous investment credit carryback to 1963 was "attributable to" the NOL carryback from 1969 to 1966 within the meaning of section 6501(j)). Accord Heasley v. Commissioner, T.C. Memo. 1988-408 (Court found that section 6659 applied to underpayments in 1980 and 1981 caused by the disallowance of credits carried back from 1983).

In conclusion, for the reasons set forth above, it is the position of the Service that section 6661 should not be applied to an underpayment in a year for which the return is due prior to January 1, 1983, even though it was caused by the disallowance of a NOL carryback from a year for which a return is due after December 31, 1982. Thus, we recommend that the addition to tax under section 6661 be conceded for the taxable year [REDACTED].

If you have any questions concerning this tax litigation advice, please contact Jo Lynn L. Ricks at FTS 566-3350.

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By: Kathleen E. Whatley  
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Chief, Tax Shelter Branch *[Signature]*